

**GLOBAL MICROENTERPRISE CREDIT PROGRAM
(PHASE II)**

(PR-0094)

EXECUTIVE SUMMARY

BORROWER: The Republic of Paraguay

EXECUTING AGENCY: Program Technical Executing Unit (PTEU) of the Central Bank of Paraguay

AMOUNT AND SOURCE:

IDB:	US\$20.0 million (OC)
Local counterpart funding:	US\$ 2.0 million
Total:	US\$22.0 million

Technical assistance:

IDB:	US\$ 2.2 million (Net income of the FSO ? local currency)
Local counterpart funding:	US\$ 0.8 million
Subtotal:	US\$ 3.0 million
Total:	US\$25.0 million

**FINANCIAL
TERMS AND
CONDITIONS:**

OC loan:

Amortization period:	20 years
Commitment period:	3 years
Disbursement period:	4 years
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75% per annum on the undisbursed balance

Technical assistance (FSO-LC):
(nonreimbursable)

Commitment period:	3 years
Disbursement period:	3 ? years

Currency:
The Government of Paraguay has requested that this loan be denominated as follows: 50% in United States dollars, 25% in deutsche marks, and 25% in Japanese yen.

OBJECTIVES: The proposed operation will move forward with support for developing the production and business capacity of microentrepreneurs in Paraguay. The specific objectives of the program will be: (i) to make it easier for microentrepreneurs to have access to

credit at market rates from financial intermediaries in the formal financial system; (ii) to establish lending for microenterprise as a regular and self-sustaining activity of participating financial institutions and to eliminate the regulatory barriers that might prevent microentrepreneurs from having access to the formal financial system; (iii) to bring about changes in the way commercial banks lend to microenterprise; and (iv) to open up the program to other market operators, including cooperative banks, if on the basis of their institutional status and regulatory structure they are found to be eligible to participate in the program.

DESCRIPTION:

The proposed program will consist of two components: (i) a line of credit for microentrepreneurs, and (ii) technical cooperation funding (Annex III-1). The credit component will be used to finance 90% of the subloans that the participating IFIs grant to the target group to purchase fixed assets and fund working capital. Approximately 12,000 new loans are expected to be granted. Although the financing involved is substantial, it is justified by the considerable number of microentrepreneurs and their substantial borrowing requirements. The plan would be much the same as the one used in phase one of the global microenterprise credit program, drawing on the lessons learned and broadening the selection criteria for participation in the program. The criteria for the program are as follows: (i) up to 10 employees per microenterprise; (ii) up to US\$20,000 in production assets, (iii) up to US\$100,000 in annual sales, (iv) a maximum amount of US\$12,000 per credit, and (v) an average loan amount of up to US\$3,000 per IFI.

The principal objective of the technical-cooperation component will be to establish regular services for microenterprise. There are five reasons for this: (i) to transfer financial technology to the IFIs in order to enhance their lending capacity and the financial services they offer, through the use of best practices to lower operating costs and facilitate risk analysis of loans to the target group, (ii) to work with the PTEU in identifying and eliminating institutional and regulatory obstacles that impede access to credit from the formal financial system, (iii) to provide institutional strengthening for cooperative banks that meet the eligibility requirements of the program, (iv) to continue evaluating the environmental impact of the subloans, and (v) to stimulate participation by women microentrepreneurs in the program.

**ENVIRONMENTAL
CLASSIFICATION:**

The Environment Committee, at its meeting of December 17, 1996, classified this as a Category III operation. The Environmental Assessment was submitted to the Public Information Center on April 9, 1997.

IMPACT ON POVERTY:

The program targets microentrepreneurs in low-income groups in Paraguay and contains components that will help to reduce poverty and achieve greater social equity. As the operation will focus on investment to alleviate poverty and more than one half of the end beneficiaries will be in low-income groups, the financing matrix to be applied will permit the Bank to finance 90% of the program.

**PARTICIPATION BY
WOMEN:**

The program will encourage participation by women microentrepreneurs, who account for 37% of all microentrepreneurs in urban areas and 57% of one-man operations, mainly in business and services. They also received 47% of the credits granted in phase one of the program. Providing credit for microenterprise is crucial to addressing the issue of poverty reduction in Paraguay. Widening the coverage of the program to include rural areas given the high participation by women in family farming, who in many cases are heads of household, will contribute still further to accomplishing this social objective.

As part of the program, mechanisms will be developed to identify and resolve the obstacles hindering access by women microentrepreneurs to credit. This program will push ahead with the efforts commenced in phase one and the training courses, in conjunction with a worker training program, in which 74% of the participants were women. It will also continue to incorporate the gender dimension in training courses as well as to heighten awareness among women micro-entrepreneurs of their legal rights. The courses will seek to apply a business approach to the task carried out by women.

BENEFITS:

The favorable effects of the program and its various components will be: (i) to raise productivity and production by microentrepreneurs, (ii) to consolidate their access to formal credit, (iii) to broaden the range of eligible intermediaries, (iv) to develop new facilities, such as leasing, the use of a credit card, and voluntary savings by participants, (v) to promote participation by women microentrepreneurs, and (vi) to focus the attention of microentrepreneurs on the importance of environmental protection. Opening up the program to other nonfinancial credit

providers will increase the coverage of subloans in urban and rural areas.

RISKS:

One of the risks to the operation is that the macroeconomic program will be suspended and price instability will reemerge, factors that would act as a disincentive to investment and borrowing, and to the willingness of IFIs to lend. Based on past performance, the government's actions give every reason to assume that conditions will remain stable in the country, despite the problems encountered.

Another risk is the possibility of making the regulatory standards and the classification of assets, credit risks, provisions, and accrued interest more flexible. Given the fragile condition of the national banking system, increasing flexibility will make it possible for many banks to evade compliance with the Basle standards and other requirements that are necessary for participation in the program. To minimize this risk, the eligibility criteria will be rigorously applied to ensure that only financially solvent, competitive institutions whose experience has been good with low levels of nonperforming loans in spite of the limited number of borrowers. The BCP will report to the Bank periodically on the condition of the financial system as well as the condition of IFIs taking part in the program. The operation will emphasize the development of a credit card for microenterprise with a centralized risk appraisal system for proper assessment of the subborrowers.

Another risk is that the credit unions do not attain the institutional standing that is needed for access to program resources. However, the program will continue to be implemented with eligible banks and finance companies, and their involvement is expected to be sufficient for the proceeds of the loan to be committed.

The risk of the PTEU losing its effectiveness, and thereby undermining the establishment of credit for microenterprise in the Paraguayan financial system should also be considered. At present, the PTEU's effectiveness depends largely on the technical assistance it receives. To minimize this risk, technical assistance will continue to be provided for a limited period as the PTEU starts hiring fewer phases out its reliance on outside consultants. By the end of this period, sufficient local staff should have been trained under the technical assistance to enable the program to function fully on its own without outside support. This is essential for the

credit support to microenterprise to become firmly established as a normal and regular practice in the financial system, and ceases to be an activity sustained by external technical assistance component.

The BCP is committed to ensuring that personnel employed by the PTEU will keep their positions and that they receive the training needed to continue performing their functions.

**THE BANK'S
COUNTRY AND
SECTOR STRATEGY:**

Under the Eighth Replenishment, poverty reduction and social equity were pinpointed as key areas for Bank involvement. To achieve these objectives, the Bank has placed the microenterprise sector high on its agenda, as part of its strategy for the country, in view of the sector's role in economic activity and job creation and the constraints that circumscribe its development. The proposed program is consistent with the Bank's strategy of serving the needs of microentrepreneurs who are mainly from low-income groups.

**CONDITIONS
PRECEDENT TO
DISBURSEMENT:**

Prior to the disbursement of resources, the borrower shall demonstrate, to the satisfaction of the Bank, that: (i) it has entered into an agreement with the BCP, whereby the latter takes on the functions of executing agency for the program, and (ii) it has implemented the Credit Regulations for the program.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

These conditions are:

- (i) When 50% of the proceeds of the loan have been committed for subloans, the borrower shall demonstrate that it has presented a plan to reduce the PTEU's operational reliance on external consultants and a schedule for implementing this plan;
- (ii) the addition of cooperative banks will be predicated on the implementation of the corresponding regulations and a chart of accounts therefor (paragraphs 3.6 and 4.9);
- (iii) the borrower and the Bank will conduct evaluations when 25%, 75%, and all of the program resources have been committed in order to determine: (a) the number and quality of the IFIs taking part; (b) willingness to serve the IFIs through the percentage of the portfolios going to microenterprise; (c) number of loans granted and quality of the portfolio; (d) number of officials assigned to microenterprise; (e) participation by cooperative banks; and (f) annual

increase in operations with microenterprises classified by gender, volume, purpose, geographic location, and line of business (paragraph 3.24);

- (iv) the borrower shall report each year on the condition of the financial system and particularly on the capitalization, solvency, and profitability of its institutions (paragraph 3.25);
- (v) within the first 12 months of the program, the BCP shall submit to the Bank its recommendations on a strategy for credit card use (paragraph 3.32);
- (vi) for the technical assistance, at least 90 days before the consultants are hired, the borrower shall submit to the Bank for approval the terms of reference for consulting services (Annex III-1).